COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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ASST. AUDITOR-CONTROLLERS

ROBERT A. DAVIS
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JUDI E. THOMAS

July 27, 2011

TO: Supervisor Michael D. Antonovich, Mayor
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe

FROM: Wendy L. Watanabe *Wendy L. Watanabe*
Auditor-Controller

SUBJECT: **AUDIT OF FIRST 5 LOS ANGELES – PHASE ONE (Board Agenda Item 12-B, February 22, 2011)**

On February 22, 2011, your Board instructed the Auditor-Controller (A-C) to Assist First 5 Los Angeles' (First 5 L.A.) ad hoc committee (Committee) in developing a Statement of Work for an independent audit, soliciting proposals for the audit and selecting the auditor, monitoring the work of the independent auditor over the course of the audit, and providing monthly progress reports as well as a final report, both to the Commission and to the Board. You also directed the A-C to bill First 5 L.A. for our assistance.

A-C staff met with the Committee, drafted a statement of work and assisted in soliciting proposals. Harvey M. Rose Associates, LLC (Harvey Rose) was selected as the auditor for Phase One of this project. The purpose of Phase One was to review and validate First 5 L.A.'s reserved and available funds and to evaluate financial information reported to First 5 L.A.'s Board of Commissioners. Harvey Rose's final report (Attachment I) was submitted to First 5 L.A.'s Board on July 12, 2011.

Phase Two of the audit will examine various programmatic, management and policy issues at First 5 L.A. We will continue to assist the Committee as needed, monitor the contractor's progress during Phase Two, and report back to your Board when the audit is complete. The A-C has billed First 5 L.A. for our costs to date.

Please call me if you have any questions, or your staff may call Robert Campbell at (213) 253-0101.

WLW:JLS:RGC

Attachment

c: William T Fujioka, Chief Executive Officer
Sachi A. Hamai, Executive Officer, Board of Supervisors
Audit Committee
Public Information Office

Procedures Engagement
Phase One Report
First 5 LA

Submitted to the

First 5 LA

Ad Hoc Committee

and Board of Commissioners

by

Harvey M. Rose Associates, LLC

http://www.harveyrose.com

July 12, 2011

HARVEY M. ROSE
ASSOCIATES, LLC
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public sector management consulting

HMR

July 12, 2011

Mayor Michael D. Antonovich, Chair
First 5 LA Commission
Members of the Ad Hoc Committee
Members of the First 5 LA Commission
750 N. Alameda Street
Los Angeles, California 90012

Dear Chair Antonovich, Members of the Ad Hoc Committee and Members of the Commission:

Harvey M. Rose Associates, LLC is pleased to present this Phase One report for our *Procedures Engagement of First 5 LA*. This report was prepared in response to your Board's request, as delegated to the Ad Hoc Committee, for an independent assessment of the agency's reserved and available funds, financial reporting to your Board and other financial matters.

Thank you for providing our firm with the opportunity to conduct this procedures engagement of First 5 LA. We are available at any time to respond to questions about the contents of this report.

Sincerely,

Fred Brousseau
Project Manager

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Executive Summary

Harvey M. Associates, LLC (HMR) was retained to conduct Phase One of this *Procedures Engagement of First 5 Los Angeles*. First 5 Los Angeles, through an ad hoc committee appointed by the organization's Board of Commissioners, requested a procedures engagement study conducted in two phases. The purpose of Phase One was to review and validate First 5 LA's reserved and available funds and to evaluate financial information reported to the Board of Commissioners.

The results of the procedures engagement are presented in three report sections, each containing findings, conclusions and recommendations. A summary of the findings and the recommendations from each report section are as follows.

1. Allocations and Controls

- Key financial actions taken by the First 5 LA Board of Commissioners (Board) include: approval of the agency's program and initiative allocations; approval of the Program Budget governing annual expenditures on initiatives and programs; and approval of the First 5 LA's Operating Budget. The Board also approves some contracts and grants.

- A review of staff information packets provided to the Board in advance of Board meetings and Board and Operations Committee meeting agendas and minutes showed that information provided to the Board regarding establishment of and changes to allocations, the Program and Operating Budgets and contract and grant agreements is inconsistent. Many Board actions are not clearly documented in meeting minutes. As a result, staff can be left in the role of interpreting or deciding allocations and budget changes and possibly making expenditure decisions inconsistent with Board direction.

- A review of minutes from Board meetings from July 1, 2010 through February 28, 2011 revealed that the Board clearly approved \$127.5 million in new Fiscal Year 2010-11 allocations but that documentation of approval of \$67.6 million in reductions to existing allocations was inconsistent, ranging from the approval of a formal motion for a change to one allocation to no record at all of Board approval for another allocation. Staff does produce monthly financial reports for the Board that incorporates the results of these changes but a standardized explanation of the changes is not presented with these reports.

- The Board received limited details regarding the \$167 million FY 2010-11 Program Budget in advance of or at the June 2010 Board meeting when it was approved. In contrast, the Board was provided with a detailed document for the \$12 million Operating Budget. However, neither the full Board nor the Operations Committee (a) receives information in a consistent, comprehensive format explaining changes to either budget that occur throughout the year; or (b) specifically approves changes to the Operating Budget that occur throughout the year. In FY 2010-11, the Operating Budget increased by approximately \$5 million as of February 28, 2011 without clear documentation of the reasons for the increase. Such changes are reflected in the Board-approved Monthly Financial Reports but without explanation.

- New contractor and grant agreements do not consistently undergo Board approval. The majority of grants and contracts are multi-year and renewal occurs under the supervision of First 5 LA staff. Agency records show 67 of the current grant agreements and contracts began after the FY 2010-11 Program Budget was approved in June 2010, but the Board did not approve all of these.

Based on the above findings, it is recommended that the First 5 LA Board of Commissioners:

1.1 Direct management to prepare policies and procedures for Board approval requiring: (a) Board approval, by vote, of changes to existing allocations and the establishment of new allocations; (b) the submission of standardized financial information to the full Board in advance of proposed allocation changes; and, (c) a standardized approach to recording and maintaining records of Board approval of changes to allocations.

1.2 Direct management to prepare policies and procedures for Board approval requiring: (a) Board approval, by vote, of mid-year line item changes in the First 5 LA Operating Budget in amounts greater than $25,000; (b) the submission of standardized comprehensive financial information to the Board in advance of Operating Budget line item changes in amounts greater than $25,000; and, (c) a standardized approach to recording and maintaining records of Board approval of changes in the Operating Budget.

1.3 Direct management to prepare policies and procedures for Board approval outlining the Board approval process for new grant agreements and contracts with clearly designated annual dollar thresholds, even for multi-year agreements, and other characteristics triggering required Board approval.

1.4 Direct management to adopt the use of standardized forms and templates so that all items requiring Board approval of new or modified funding for allocations, budgets or grants and agreements are clearly identified in agenda packets and clearly recorded in Board minutes for staff use.

2. Review of a Sample of First 5 LA Transactions

- To assess controls and verify the reliability of First 5 Los Angeles' reported expenditures, reserves and available cash balances, a review was conducted of 68 expenditure transactions and corresponding agreements with grantees and contractors. The transactions all took place between June 30, 2010 and February 28, 2011. The purpose of the review was to verify that agency expenditures are properly controlled and reported changes in reserves and available funds are accurately tied to expenditure transactions.
- Three types of transactions were reviewed: (1) payments to contractors, (2) payments to grantees, and (3) other payments including those used to support First 5 administrative operations or to reimburse initiatives/programs for expenditures related to Medi-Cal Administrative Activities.
- In general, transactions reviewed were adequately documented. Amounts invoiced and paid were consistent with amounts allowed for the contractor or grantee in their executed

agreements, and payments for all transactions were authorized by required staff signatures on Payment Authorization forms. However, the review found that program, contract compliance, and financial management controls over expenditures could use improvement.

- The transaction review showed that some grantees are spending in categories that do not match their approved grant agreement budget, or are submitting incomplete or inaccurate spending information. In cases where invoices and budgets differed, required paperwork authorizing the change was not on file with related documentation such as invoices, contract and grant agreements. Reporting associated with contractor invoices was inconsistent in terms of the level of detail included in both the contract's budget document and in the invoice. Not all contract budgets specified level of services or materials to be provided, and even fewer invoices specified level of services or materials provided during the payment term. Non-grantee and contractor payments often lacked supporting documentation that identified initiatives or programs associated with the expenditures, making it difficult to determine if the expenditures support general First 5 LA activities and/or initiatives/programs.

- Of the transactions reviewed, 49 percent of grantees and 21 percent of contractors in the sample did not submit their invoice within the required period, although First 5 LA provided payment for these invoices within the required period. Invoices that were not submitted on time were between one and four months late.

Based on the above findings, it is recommended that the First 5 LA Board of Commissioners:

2.1 Direct management to report back on new procedures and controls in place to ensure that First 5 LA staff monitors grantees and contractors to ensure compliance with financial reporting policies which state that grantees and contractors must submit invoices that demonstrate spending in accordance with the line-item budgets approved in each contract or agreement.

2.2 Implement a policy that requires that all contractors submit budgets and invoices that specify the units of goods or specific service to be provided during the contract term.

2.3 Implement a policy to ensure contractors consistently specify the initiative/program, or internal First 5 LA department associated with each invoice submitted.

3. Accounting for Reserves, Designations and Fund Balance

- Reserves and designations of fund balance for First 5 LA programs are derived from allocations authorized by the First 5 LA Commission. However, the accounting process for tracking and monitoring allocations, reserves and designations of fund balance has several weaknesses, including: (1) lack of procedural consistency in the use of spreadsheets and manual calculations to determine reserved and unreserved fund balance amounts; (2) lack of controls over allocation amounts; (3) lack of monthly reconciliations between amounts reported and financial records; and, (4) absence of written policies and procedures for agency financial processes.

- Total fund balance is estimated to have been approximately $925,391,252 as of February 28, 2011, though a complete reconciliation of agency accounts and financial transactions is needed to verify this amount. First 5 LA does not maintain an accounting month to month of fund balance and associated allocations, reserves and designations. Variances identified during reconciliation of accounts and transactions prevented our verifying reserves and fund balance components as of February 28, 2011. For example, reconciliations showed the remaining balance in eight allocations to be insufficient to cover total reserves for those programs/initiatives.

- Despite procedural challenges, the Finance Department should be recognized for its ability to manually track and identify accounting transactions and process accounting exceptions in detail. Numerous requests by project staff for explanation of accounting variances were addressed quickly and thoroughly. By addressing accounting process weaknesses and shifting to quarterly financial status reports, management and Finance Department staff would realize greater efficiency and be better equipped to provide improved financial information to the Board. An assessment of agency tools and resources needed, if any, to address these issues was not conducted as part of this procedures engagement.

- First 5 LA management should develop and implement agency-specific written policies and procedures to clarify and strengthen accounting processes and controls regarding allocations, reserves, and designations and conduct formal reconciliations quarterly for financial reports to the Board.

- Sufficient data and information is known about reserves and designations for the Commission to determine how to prioritize funding in the event that it must remit $424,388,705 to the State pursuant to Health and Safety Code Section 130158.

Based on the above findings, it is recommended that the First 5 LA Board of Commissioners:

3.1 Direct management to develop agency-specific written policies and procedures for (1) manual compilations of financial information, (2) allocations, reserves, and designations, and (3) quarterly reconciliations. Such policies and procedures should include adequate financial controls over the use of allocations.

3.2 Direct management to conduct formalized and methodical quarterly reconciliations and compilations for financial reporting purposes that account for timing differences and required adjustments to better reflect financial status.

3.3 Direct management to present revised financial policies and procedures and financial controls to the Board for review and approval.

3.4 Direct management to report audited fund balance as of June 30, 2011 as soon as practicable to the Board.

3.5 Direct management to prepare and submit quarterly financial reports to the Board based on full reconciliations of agency accounts and expenditures, and reporting fund balance elements as reported in the agency's audited Comprehensive Annual Financial Report (CAFR).

Introduction

Harvey M. Associates, LLC (HMR) was retained to conduct Phase One of this *Procedures Engagement of First 5 Los Angeles.* First 5 Los Angeles, through an ad hoc committee appointed by the organization's Board of Commissioners, requested a procedures engagement study conducted in two phases. The purpose of Phase One was to review and validate First 5 LA's reserved and available funds, material changes in allocations, and to evaluate financial information reported to the Board of Commissioners.

Project Purpose and Scope

The overall objectives of Phase One of this procedures engagement was to review and validate First 5 LA's reserved and available funds. Specific objectives included evaluating and verifying the reporting and classification of agency reserves, analyzing a sample of transactions that resulted in changes to reserve amounts, evaluating changes in allocations to individual programs and initiatives and reviewing the financial information prepared for the First 5 LA Board of Commissioners. The overall objective of the project was to strengthen the criteria for defining and establishing reserves, the process by which reserve amounts are adjusted, and the reporting of such reserves to the First 5 LA Commission.

Project Methods

To accomplish these objectives, Harvey M. Associates, LLC staff interviewed representatives of the First 5 LA's Board of Commissioners (the Board) and the ad-hoc committee, as well as First 5 LA management and staff responsible for accounting, contracting and reporting to the Commission. A compilation of information obtained and reviewed for use as baseline information for our Phase One report included First 5 LA's annual audited financial statements for the most recent three fiscal years; the agency's strategic plan; pertinent State laws; First 5 California and First 5 LA agency directives and policies detailing policies and procedures pertaining to negotiating and approving contracts, allocating funds to program initiatives, and accounting for all reserves and allocations; summary data on all First 5 contracts; contract management system documentation; and, Board of Commissioners and Operations Committee agendas, meetings and supporting documentation provided to the Board. Detailed financial records including the agency's check register and various reports and documentation were also provided and analyzed.

In order to verify the reporting and classification of agency reserves, we compared the amounts reported as reserves as of June 30, 2010 to those reported for the same date for Fiscal Year 2008-09 in the Comprehensive Annual Financial Reports (CAFRs) for each year. For the February 28, 2011 reserve balance we reviewed the results of staff's monthly close-outs in which accounting ledgers are rolled up to get month-end balances.

Further validation of the February 28, 2011 balance occurred through our review of sample agency expenditure transactions. In order to validate First 5 LA's procedures and controls for processing and recording expenditures and financial transactions that result in changes to the agency's reserves and available funds, a review was conducted of First 5 LA's accounting system reports, ledgers, and contract records and a sample of actual transactions from between

June 30, 2010 and February 28, 2011. For this review, 58 transactions were initially selected for review using a stratified random sample of all expenditure transactions that have caused, or should have caused, changes in First 5 LA's reserves and took place between June 30, 2010 and February 28, 2011. Because the initial random stratified sample did not include any high dollar value transactions of over $100,000, a judgmental sample was added of ten expenditure transactions with values of over $100,000 each, for a grand total of 68 transactions reviewed.

We also obtained and reviewed all material changes in allocations to individual programs that have occurred between July 1, 2010 and February 28, 2011 to verify that the changes were authorized by First 5 LA's Board of Commissioners, pursuant to applicable laws and First 5 LA policies and procedures. Finally, we obtained and reviewed key financial information prepared by First 5 LA staff for the First 5 LA Board of Commissioners in order to identify and make recommendations for any additional financial statements or reports that should be submitted.

Based on our research and analysis, we provided detailed schedules of the Commission's reserves and unrestricted fund balance as of February 28, 2011; we also developed the findings and recommendations that are the subject of this report. Once the draft report was completed, it was submitted to First 5 Los Angeles management for review and comments. This final report was prepared subsequent to receiving comments from agency management.

Acknowledgements

Harvey M. Rose Associates, LLC would like to thank the ad hoc committee of the Board of Commissioners and First 5 management and staff that participated in this project for their time and assistance. First 5 LA staff, particularly the Finance Director and her staff, were extremely helpful and professional and took considerable time to discuss their accounting and financial procedures and provide much detailed information to the project team. Throughout the audit, these individuals were cooperative and ensured that our requests for information were met.

1. Allocations and Board of Commissioner Approval of the Annual Budgets and Contracts

- **Key financial actions taken by the First 5 LA Board of Commissioners (Board) include: approval of the agency's program and initiative allocations; approval of the Program Budget governing annual expenditures on initiatives and programs; and approval of the First 5 LA's Operating Budget. The Board also approves some contracts and grants.**
- **A review of staff information packets provided to the Board in advance of Board meetings and Board and Operations Committee meeting agendas and minutes showed that information provided to the Board regarding establishment of and changes to allocations, the Program and Operating Budgets and contract and grant agreements is inconsistent. Many Board actions are not clearly documented in meeting minutes. As a result, staff can be left in the role of interpreting or deciding allocations and budget changes and possibly making expenditure decisions inconsistent with Board direction.**
- **A review of minutes from Board meetings from July 1, 2010 through February 28, 2011 revealed that the Board clearly approved \$127.5 million in new Fiscal Year 2010-11 allocations but that documentation of approval of \$67.6 million in reductions to existing allocations was inconsistent, ranging from the approval of a formal motion for a change to one allocation to no record at all of Board approval for another allocation. Staff does produce monthly financial reports for the Board that incorporates the results of these changes but a standardized explanation of the changes is not presented with these reports.**
- **The Board received limited details regarding the \$167 million FY 2010-11 Program Budget in advance of or at the June 2010 Board meeting when it was approved. In contrast, the Board was provided with a detailed document for the \$12 million Operating Budget. However, neither the full Board nor the Operations Committee (a) receives information in a consistent, comprehensive format explaining changes to either budget that occur throughout the year; or (b) specifically approves changes to the Operating Budget that occur throughout the year. In FY 2010-11, the Operating Budget increased by approximately \$5 million as of February 28, 2011 without clear documentation of the reasons for the increase. Such changes are reflected in the Board-approved Monthly Financial Reports but without explanation.**
- **New contractor and grant agreements do not consistently undergo Board approval. The majority of grants and contracts are multi-year and renewal occurs under the supervision of First 5 LA staff. Agency records show 67 of the current grant agreements and contracts began after the FY 2010-11 Program Budget was approved in June 2010, but the Board did not approve all of these.**

A review of First 5 LA Commission documents from FY 2010-11 shows that First 5 LA staff has not established policies or protocols governing information to be provided to the First 5 LA Board of Commissioners (Board) in advance of or at its meetings for Board action items on fiscal matters. Further, a standardized approach to recording Board approval of changes in allocations and to the Agency's Program and Operating Budgets is not in place.

Documents reviewed included information packets provided to the Board in advance of their full Board and Operations Committee meetings, meeting agendas and meeting minutes for the period between March 2010 and February 28, 2011. These were compared to originally approved and any modified allocations and the Program and Operating Budgets, as reported in the Monthly Financial Reports provided to the Board.

Allocations

A review was conducted of all material changes in allocations to all programs and initiatives that occurred between July 1, 2010 and February 28, 2011, specifically all decreases and increases to existing allocation amounts and the establishment of all new allocations. During this time, total allocations increased by a net of $59,921,342, or 4.5 percent, from $1,340,940,693 as of June 30, 2010 to $1,400,862,035 as of February 28, 2011. This net increase is the result of (a) $127,537,619 in new allocations approved by the Board after June 30, 2011 and associated with the Countywide Augmentation Plan, and (b) a $67,643,993 decrease in existing allocations, most of which are being used to fund grants and contracts.

In order to verify the financial information flow between staff and the Board and the Board's role in approving changes to allocations, we attempted to validate the changes in allocations reported in the agency's Monthly Financial Reports against Board actions recorded in the minutes from Board meetings that occurred between March 2010[1] and February 2011. A review of Board minutes indicated that the Board explicitly approved all new allocations, as shown in the Countywide Investments section of Exhibit 1.1, below.

Items in the minutes detailing Board decisions related to increases and decreases in allocation amounts were inconsistent, ranging from the approval of a formal motion to no record of approval at all in any Commission minutes. For example, the Board approved a change in the Best Start Los Angeles allocation via a formal motion to transfer $70 million of funds from the program to the agency General Fund. In comparison, changes to the Early Childcare Development, Family Literacy Expansion Grants, Partnership for Families and Los Angeles Best Babies Network (Healthy Births) allocations were all approved by the Board as part of a Transition Plan but without identification of the specific changes to these programs and initiatives in Board minutes. In other cases, such as a reduction in the allocation for La Petite Academy, no Board action was apparent from a review of the pertinent minutes. Exhibit 1.1 shows changes in allocations that occurred between June 30, 2011 and February 28, 2011.

[1] March 2010 was selected as the starting point for this review since some FY 2010-11 allocation and Budget information was presented in advance of the start of the fiscal year, July 1, 2010.

Appendix I at the end of this section offers a more detailed description of Board action or discussion associated with each change in allocation as apparent from a review of Commission minutes.

Information regarding changes in allocations provided to the Board by staff in advance of Commission meetings is inconsistent. Of the 15 allocation changes that occurred between June 30, 2010 and February 28, 2011, only eight were addressed in Commission packets and, of those, only one Commission packet listed a dollar amount associated with the proposed change.

Information about new allocations in the informational packets issued to the Board in advance of their meetings between March 1, 2010 and February 28, 2011 was also inconsistent. For example, budget details and a comprehensive description of programmatic goals was included in the October 14, 2010 Commission packet associated with the proposed allocation for the East Los Angeles College Care Providers allocation. In contrast, the description of the proposed LA Tot Parks and Trails allocation, also included in the October 14, 2010 packet, was limited to a brief one half-page overview of potential grants associated with the proposed allocation. Complete and consistent information should be provided to Board members for all proposed changes to and new allocations so that members can make informed approval decisions, as well as to increase transparency regarding the use of First 5 LA funds.

Discussion of allocations often took place during the Operations Committee, a subcommittee of the full Board that deals with fiscal and other matters related to First 5 LA operations. While the Operations Committee is not authorized to make financial decisions during its meetings, the discussion during these Committee meetings provides content that might inform or impact full Board hearings and votes. However, agendas and minutes from these meetings are not consistently provided to Board members and a formal structure for the Committee to report to the full Board is not in place. At least some of the audio recordings of Operations Committee meetings are incomplete or difficult to understand.

The Operations Committee has met at least five times in 2011. Minutes associated with these meetings were not initially available for the procedures engagement team and therefore had not been approved or distributed to all Board members as of July 1, 2011. The Operations Committee met on at least three occasions in 2010. Minutes from the April 12 and May 26, 2010 meetings have been typed and approved. Minutes from the October 4, 2010 meeting are not available in written form and the audio recording of the meeting is unintelligible. Also, in contrast with the full Board minutes, Operations Committee minutes do not specify speakers and audio recordings revealed that significant portions of discussion that occurred during the meetings were not in the minutes.

Exhibit 1.1: Changes to Allocations: June 30, 2010 through February 28, 2011

	Total Allocation as of June 30, 2010	Total Allocation as of February 28, 2011	Changes in Allocation	Date of Change in Monthly Statements	Commission Packet Reference to Proposed Changes to Allocation	Commission Packet Details Proposed Changes to Allocation Amount
Multiple Year Grants and Contracts						
Family, Friends and Neighbors	$3,600,000	$4,583,722	$983,722	July 31, 2010	✓	
Workforce Development	11,400,000	6,547,029	(4,852,971)	July 31, 2010	✓	
Family Literacy Expansion Grants	20,800,000	20,278,341	(521,659)	July 31, 2010	✓	
Partnership for Families	50,000,000	53,413,279	3,413,279	July 31, 2010	✓	
Altmayer Consulting	98,999	149,159	50,160	July 31, 2010		
LA Best Babies Network (Healthy Births)	28,000,000	29,244,627	1,244,627	July 31, 2010	✓	
La Petite Academy	92,500	49,803	(42,697)	July 31, 2010		
LAUP	580,000,000	580,000,000				
MAA - LA County Charges	260,000	287,716	27,716	July 31, 2010		
Public Education	10,258,768	10,258,768				
Best Start LA	125,000,000	55,000,000	(70,000,000)	July 31, 2010	✓	✓
Cross-Cutting Approaches	3,196,212	3,317,160	120,948	Jan 31, 2011		
MRMIB	3,809,286	2,446,368	(1,362,918)	July 31, 2010		
Oral Health Community Development (OHCD)	20,000,000	13,100,000	(6,900,000(	Jan 31, 2011	✓	
Oral Health/Nutrition Expansion	10,000,000	16,900,000	6,900,000	Jan 31, 2011	✓	
Technical Assistance Institute	612,500	450,058	(162,442)	July 31, 2010		
Black Infant Health	2,323,972	5,809,930	3,485,958	July 31, 2010	✓	
Sub-Total Multiple Year Grants and Contracts	**1,288,322,943**	**1,220,706,666**	**(67,616,277)**			

	Total Allocation as of June 30, 2010	Total Allocation as of February 28, 2011	Changes in Allocation	Date of Change in Monthly Statements	Commission Packet Reference to Proposed Changes to Allocation	Commission Packet Details Proposed Changes to Allocation Amount
Countywide Investments						
East LA College Child Care Providers		1,057,952	1,057,952	Dec 31, 1010	✓	✓
Tot Parks and Trails		10,000,000	10,000,000	Dec 31, 1010	✓	✓
Infant Safe Sleeping		1,500,000	1,500,000	Dec 31, 1010	✓	✓
Connecting Risk and Perinatal Service		200,000	200,000	Dec 31, 1010	✓	✓
Data Partnership With Funders		5,000,000	5,000,000	Dec 31, 1010	✓	✓
ECE Workforce Consortium		37,079,667	37,079,667	Dec 31, 1010	✓	✓
Peer Support Groups for Parents		2,200,000	2,200,000	Dec 31, 1010	✓	✓
Substance Abuse Services		15,000,000	15,000,000	Dec 31, 1010	✓	✓
Healthy Food Access Initiative		7,500,000	7,500,000	Dec 31, 1010	✓	✓
One Step Ahead		30,000,000	30,000,000	28 Feb 2011	✓	✓
Workforce Development		3,000,000	3,000,000	Jul 31, 1010	✓	✓
Cal-Works 3 Funding		15,000,000	15,000,000	Oct 31, 2010	✓	✓
Sub-Total Countywide Investments	**52,617,750**	**180,155,369**	**127,537,619**			
Total	**$1,340,940,693**	**$1,400,862,035**	**$59,921,342**			

Source: First 5 LA grantee/contractor database

Inconsistencies in (a) Board approval of changes in allocations, (b) financial information provided to the Board in advance of allocation changes, and (c) records of the Board's approval process indicate a need for agency policies and procedures governing both changes to existing allocations and the establishment of new allocations. Due to the lack of such guidelines, changes to existing allocations may or may not undergo Board approval, raising the possibility that staff could make decisions and expend funds in a way that is not consistent with Board direction and policy. Although the Board approves new allocations, no policies or procedures govern the approval process, including what information is provided to Board members about a proposed new allocation or changes to an existing allocation, for use in informing the approval decision. Finally, no easily accessible record provides a history of Board approval, making it difficult to review annual changes in allocations and to ensure staff is adhering to Board policy direction.

Operating and Program Budgets

The Fiscal Year 2010-11 First 5 LA Operating and Program budgets were approved by the Board during the June 10, 2010 Commission meeting. Prior to the meeting Board members received packets containing a detailed proposed $12.7 million Operating Budget. In contrast, members received very limited details regarding the proposed $162.9 million Program Budget. Whereas Monthly Financial Reports list expenditure amounts for all approved allocations, the Board packet with information addressing the proposed Program Budget had no specific annual budget information for multi-year grants and contracts that were not part of the new Countywide Investments allocations. With the exception of Los Angeles Universal Preschool (LAUP), the Table detailing the 2010-11 Program Budget listed all existing allocations as a single line-item categorized as "Prior Strategic Plan Investments" in the amount of $56.5 million for FY 2010-11. No additional information about the proposed annual spending for each of these 31 program/initiative allocations that fall under "Prior Strategic Plan Investments" was provided to Board members. Thus members had limited information available when making the Program Budget approval decision.

Monthly changes in the Operating Budget are reflected in Monthly Financial Reports provided to Board members prior to each Board meeting. The First 5 Los Angeles Board of Commissioners *Policy and Guidelines for the Commission's Annual Operating Budget* specifies,

> "It shall be the policy of the Board of Commissioners that the Executive Director has the authority to make budget adjustments between line items in the Commission's Annual Operating Budget in an amount not to exceed $25,000. Any budget adjustment between line items in excess of $25,000 requires approval of the Operations Committee of the Board of Commissioners."

All mid-year line item changes to the Fiscal Year 2010-11 Operating Budget identified in the Monthly Financial Reports were greater than $25,000. The Board typically approves Monthly Financial Reports for the prior month during each Board meeting. However, neither the full Board nor the Operations Committee (a) receives consistent, easily accessible information explaining changes in the Operating Budget or (b) specifically approves changes to the Operating Budget. Further, because the monthly statements include budgets only for one month, Board members cannot easily identify changes to the Operating Budget from one month to the next. A review of Board meeting minutes indicates that the Board typically approves Monthly Financial Reports without discussion, suggesting that Board members may not be made aware of changes in the Operating Budget, which are not pointed out in any financial documentation.

Exhibit 1.2 below shows changes to the FY 2010-11 Operating Budget since it was approved during the June 10, 2010 meeting. Increases occurred in the four expenditure categories: Personnel Related Expenses, General Operating Expenses, Professional and Consultant Services, and Travel and Meetings.

Exhibit 1.2: Changes to the Annual Operating Budget Total per Monthly Financial Reports: June 30, 2010 - February 28, 2011

Monthly Financial Report Date	Total Budget	Change from Previous Month
Adopted 6/10/10	$12,709,972	
7/31/10	12,651,511	($58,461)
8/31/10	12,651,511	0
9/30/10	15,408,647	2,757,136
10/31/10	16,671,147	1,262,500
11/30/10	16,671,147	0
12/31/10	16,642,003	(29,144)
1/31/11	17,685,821	1,043,818
2/28/11	17,685,821	0
Cumulative Change		$4,975,849

Source: First 5 LA Monthly Financial Reports

First 5 LA staff provided the procedures engagement team with the following explanation of the changes to the Operating Budget: approximately $2.7 million in changes were approved by the Board as part of the Implementation Plan, $1.77 million in changes to the Operating Budget related to the School Readiness Initiative contract, and $500,000 in changes was for use in building improvements. First 5 staff advised that these changes were addressed in information in Board packets distributed to members in advance of the June 10, 2010 and February 10, 2011 Board meetings. However, we did not locate the specific dollar amounts related to these changes in the Board packets, nor did the minutes from the corresponding Board meetings indicate that the Board specifically approved changes to the Operating Budgets in the amounts listed in Exhibit 1.2.

Grant Agreements and Contracts

First 5 LA maintains a document entitled, *All Departments Policy and Guidelines for Hiring Contractors* which contains the following provision regarding contractor selection:

> "Based on the outcome of the interviews and/or other selection means, Commission staff prepares the recommendation to the Board for approval of the selected Contractor."

While this language suggests that the Board approves new contracts, First 5 LA staff advised that the contracting process is not governed by a formal approval process that involves the Board and that many new contracts and grant agreements are approved by staff and do not undergo Board approval.

The majority of grants and contracts are multi-year and renewal occurs under the supervision of First 5 LA staff, although on occasion the Board may require that they approve a specific contract. The multi-year grant agreements and contracts reviewed as part of our transaction review (see Section 2) did not require re-approval by the Board, with the exception of the LAUP agreement, which requires that the Board review and approve the LAUP budget on an annual basis.

According to data provided by First 5 LA staff, 67 of the current grantee and contractor agreements have begun since the Board approved the First 5 LA Program Budget on June 30, 2010. While the data does not indicate which of these 67 grant agreements and contracts were renewals of existing agreements and contracts, several are associated with recently-approved allocations and therefore likely represent new agreements and contracts. Based on a review of Commission minutes between June 30, 2010 and February 28, 2011, however, only the following contracts were approved by the Board:

- LAUP Performance-Based Contract for FY 20101-11, $62,455,045, June 10, 2010.
- 23 Recommended Applicants in the Community Opportunities Fund Cycle 4 to perform organizational capacity building, not-to-exceed amount of $3,324,263, June 10, 2010.
- Contract Amendment and Supplemental Funding Request for the City of Torrance Municipal Water, resulting in the new total of $175, 125, February 28, 2011.

Inconsistencies in when staff brings grantee and contractor agreements to the Board for approval indicate a need for agency policies and procedures governing which contracts and grant agreements require approval by the Board. The lack of such guidelines suggests that First 5 staff could make programmatic and funding decisions that are not consistent with Board direction and policy.

To help clarify and document Board actions to ensure that all staff are following the policy direction of the agency's governing board, two possible templates for First 5 LA staff to use in their information packets and with Board agendas are presented in Exhibits 1.3 and 1.4 below. Exhibit 1.3 is a template of a document that could be used in conjunction with Board agendas to clearly identify matters that require a vote and/or have fiscal or programmatic impact. Exhibit 1.3 includes sample entries from the February 10, 2011 First 5 LA Commission meeting. Exhibit 1.4 is a template to be attached to each agenda item that requires Board action for establishing or changing an allocation, amending the approved budget or a grant/contract. The template would allow Board members and First 5 staff a standardized method of documenting Board actions to ensure that those actions are followed by staff.

Exhibit 1.3: Agenda Item Template

Category	Agenda Item (Specify Vote Requirement)	Presenter	Supporting Documents
	Approval of Previous Commission Meeting Minutes		Previous Meeting Minutes
Program	Approval of Motion Regarding Children's Oral Health **(VOTE REQUIRED)**		Documentation Detailing Children's Oral Health Program
Fiscal	Approval of Contract Amendment and Supplemental Funding Request for the City of Torrance Municipal Water **(VOTE REQUIRED)**		Proposed Budget Information
Program	Approval of Revision to FY 2009-15 Strategic Plan		Revised Draft of the FY 2009-15 Strategic Plan

Exhibit 1.4: Template for Agenda Supplement Detailing Items that Require a Board Vote or Have a Fiscal Impact

First 5 LA Allocations/ Funding Approval Motion Requisition Form

Commission Meeting ________________ Agenda Item ________________

Dollar Amount as recommended: $ ________________

Adjustments: $ ________________

Approved Amount: $ ________________

New Allocation ________________ Existing Allocation ________________

Term ________________ Strategic Goal Area ________________

Consent: Yes ____ No ____ Abstain ______

Notes:

Finance Entered Date________________

Date reflects the changes to allocation, fund balance, and financial statement made

Finance Manager Signature ________________

Director of Finance Signature ________________

Conclusions

First 5 LA's allocations have increased by a net of $59,921,342, or 4.5 percent, from $1,340,940,693 as of June 30, 2010 to $1,400,862,035 as of February 28, 2011, resulting from new allocations approved by the Board and decreases in existing allocations used primarily to fund grants and contracts. Inconsistencies exist in: (a) Board approval of changes in allocations; (b) the financial information provided to the Board in advance of allocation changes; and, (c) records of the Board approval process surrounding changes in allocations. These inconsistencies indicate a need for agency policies and procedures governing both changes to existing allocations and the establishment of new allocations. In addition, no written policies and procedures govern Board approval of First 5 LA's annual Operating or Program Budgets, or the Board's approval of contracts and grant agreements.

Recommendations

The First 5 LA Board of Commissioners should:

1.1 Direct management to prepare policies and procedures for Board approval requiring: (a) Board approval, by vote, of changes to existing allocations and the establishment of new allocations; (b) the submission of standardized financial information to the full Board in advance of proposed allocation changes; and, (c) a standardized approach to recording and maintaining records of Board approval of changes to allocations.

1.2 Direct management to prepare policies and procedures for Board approval requiring: (a) Board approval, by vote, of mid-year line item changes in the First 5 LA Operating Budget in amounts greater than $25,000; (b) the submission of standardized comprehensive financial information to the Board in advance of Operating Budget line item changes in amounts greater than $25,000; and, (c) a standardized approach to recording and maintaining records of Board approval of changes in the Operating Budget.

1.3 Direct management to prepare policies and procedures for Board approval outlining the Board approval process for new grant agreements and contracts with clearly designated annual dollar thresholds, even for multi-year agreements, and other characteristics triggering required Board approval.

1.4 Direct management to adopt the use of standardized forms and templates so that all items requiring Board approval of new or modified funding for allocations, budgets or grants and agreements are clearly identified in agenda packets and clearly recorded in Board minutes for staff use.

Costs and Benefits

Implementation of all recommendations should be accomplished using existing resources. By establishing requirements surrounding Board approval of changes to existing allocations and the establishment of new allocations, the Operating Budget, new grant agreements and contracts, the First 5 LA Board and staff will benefit from financial transparency and an improved understanding of how First 5 LA funds are spent.

APPENDIX I

	Total Allocation as of June 30, 2010	Changes in Allocation	Total Allocation as of February 28, 2011	Date of Change in Monthly Statements	Commission Packet Details	Notes from Minutes Review
Multiple Year Grants						
Family, Friends and Neighbors	$3,600,000	$983,722	$4,583,722	July 31, 2010	Material changes to allocation not explicitly stated	May 13, 2010 Item #6 Approval of Transition Plan for the FY 2009-2015 Strategic Plan: Commission approved extension of allocation but did not approve a material change.
Workforce Development	11,400,000	(4,852,971)	6,547,029	July 31, 2010	Material changes to allocation not explicitly stated	May 13, 2010 Item #6 Approval of Transition Plan for the FY 2009-2015 Strategic Plan: Commission approved extension of allocation but did not approve a material change.
Family Literacy Expansion Grants	20,800,000	(521,659)	20,278,341	July 31, 2010	Material changes to allocation not explicitly stated	May 13, 2010 Item #6 Approval of Transition Plan for the FY 2009-2015 Strategic Plan: Commission approved extension of allocation but did not approve a material change.
Partnership for Families	50,000,000	3,413,279	53,413,279	July 31, 2010	Material changes to allocation not explicitly stated	May 13, 2010 Minutes Item #6 Approval of Transition Plan for the FY 2009-2015 Strategic Plan: Commission approved extension of allocation but did not approve a material change.
Multiple Year Contracts						
Altmayer Consulting	98,999	50,160	149,159	July 31, 2010	No related content in Packet	No related content in Minutes
LA Best Babies Network (Healthy Births)	28,000,000	1,244,627	29,244,627	July 31, 2010	Material changes to allocation not explicitly stated	May 13, 2010 Item #6 Approval of Transition Plan for the FY 2009-2015 Strategic Plan: Commission approved extension of allocation but did not approve a material change.

	Total Allocation as of June 30, 2010	Changes in Allocation	Total Allocation as of February 28, 2011	Date of Change in Monthly Statements	Commission Packet Details	Notes from Minutes Review
La Petite Academy	92,500	(42,697)	49,803	July 31, 2010	No related content in Packet	No related content in Minutes
LAUP	580,000,000		580,000,000			
MAA - LA County Charges	260,000	27,716	287,716	July 31, 2010	No related content in Packet	No related content in Minutes
Public Education	10,258,768		10,258,768			
Other allocations						
Best Start LA	125,000,000	(70,000,000)	55,000,000	July 31, 2010	Packet contains relevant details	March 3, 2010 Minutes #6: Approval of motion to roll $70,000,000 of Best Start Funds over to the General Fund.
Cross-Cutting Approaches	3,196,212	120,948	3,317,160	January 31, 2011	No related content in Packet	No related content in Minutes
MRMIB	3,809,286	(1,362,918)	2,446,368	July 31, 2010	No related content in Packet	No related content in Minutes
Oral Health Community Development (OHCD)	20,000,000	(6,900,000)	13,100,000	January 31, 2011	Material changes to allocation not explicitly stated	April 3, 2010 Item #7 Approval of Change in OHCD Funding; July 8, 2010 Item #3 Selection of new strategy for the OHCD Project Implementation: In both meetings, Board appears approve general changes in oral health allocation but not $6,900,000 in material changes.
Oral Health/Nutrition Expansion	10,000,000	6,900,000	16,900,000	January 31, 2011	Material changes to allocation not explicitly stated	May 13, 2010 Item #6 Approval of Transition Plan for the FY 2009-2015 Strategic Plan: Commission approved extension of allocation but did not approve a material change.
Technical Assistance Institute	612,500	(162,442)	450,058	July 31, 2010	No related content in Packet	No related content in Minutes

	Total Allocation as of June 30, 2010	Changes in Allocation	Total Allocation as of February 28, 2011	Date of Change in Monthly Statements	Commission Packet Details	Notes from Minutes Review
Black Infant Health	2,323,972	3,485,958	5,809,930	January 31, 2011	Material changes to allocation not explicitly stated	January 11, 2011: Item #8 Approval of Motion Funding of the Black Infant Health Program, no material changes to allocation.
Sub-Total	**1,288,322,943**	**(67,616,277)**	**1,220,706,666**			
Countywide Investments						
East LA College Child Care Providers		1,057,952	1,057,952	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan; October 14, 2010 Item #10 specifies $1,057,952 allocation for East LA College Child Care Providers.
Tot Parks and Trails		10,000,000	10,000,000	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan; Oct 14, 2010 Item #11 specifies $50,000,000 allocation for Tot Parks and Trails
Infant Safe Sleeping		1,500,000	1,500,000	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan; October 14, 2010 Item #12 specifies $800,000 allocation for Infant Safe Sleeping.
Connecting Risk and Perinatal Service		200,000	200,000	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan; October 14, 2010 Item #12 specifies $200,000 allocation for Connecting Risk and Perinatal Service.

	Total Allocation as of June 30, 2010	Changes in Allocation	Total Allocation as of February 28, 2011	Date of Change in Monthly Statements	Commission Packet Details	Notes from Minutes Review
Data Partnership With Funders		5,000,000	5,000,000	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of the Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan; Oct 14, 2010 Item #15 specifies $5,000,000 allocation for Data Partnerships with Funders.
ECE Workforce Consortium		37,079,667	37,079,667	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of the Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan.
Peer Support Groups for Parents		2,200,000	2,200,000	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of the Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan. October 14, 2010 Item #18 specifies $2,200,000 allocation for Peer Support Groups for Parents.
Substance Abuse Services		15,000,000	15,000,000	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of the Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan; October 14, 2010 Item #18 specifies $5,000,000 allocation for Substance Abuse Programs.
Healthy Food Access Initiative		7,500,000	7,500,000	December 31, 2010	Packet contains relevant details	November 18, 2010 Item #7 Approval of the Countywide Augmentation Proposals for the FY 2009-2015 Strategic Plan. October 14, 2010 Item #19 approves allocation but does not specify the amount.

	Total Allocation as of June 30, 2010	Changes in Allocation	Total Allocation as of February 28, 2011	Date of Change in Monthly Statements	Commission Packet Details	Notes from Minutes Review
One Step Ahead		30,000,000	30,000,000	February 28, 2011	Packet contains relevant details	January 13, 2011 Item #10 Approval of the One-Step Ahead Initiative. Allocation amount is not specified.
Workforce Development		3,000,000	3,000,000	July 31, 2010	Packet contains relevant details	July 8, 2010 Item #7 Approval of Expansion of Countywide Workforce Development Strategies through Partnership with LAUP with an allocation of up to $7 million from the Countywide allocation and Authorize Staff to Negotiate Contracts. No mention of $3 million.
Cal-Works 3 Funding		15,000,000	15,000,000	October 31, 2010	Packet contains relevant details	October 28, 2010 Item #3 Approval of Transitional Funding Not-to-Exceed $15 Million for CalWORKS Stage 3 Childcare for the 0-5 Population in LA County Served by that Program from Nov 1, 2010 to Jan 31, 2010 and, Provide Direction to Staff Regarding the Funding Mechanism; Authorize the Chief Executive Officer or Her Designee to Negotiate and Execute Contracts.
Sub-Total	**52,617,750**	**127,537,619**	**180,155,369**			
Total	**$1,340,940,693**	**$59,921,342**	**$1,400,862,035**			

Source: First 5 LA data

2. Review of a Sample of First 5 LA Transactions

- **To assess controls and verify the reliability of First 5 Los Angeles' reported expenditures, reserves and available cash balances, a review was conducted of 68 expenditure transactions and corresponding agreements with grantees and contractors. The transactions all took place between June 30, 2010 and February 28, 2011. The purpose of the review was to verify that agency expenditures are properly controlled and reported changes in reserves and available funds are accurately tied to expenditure transactions.**

- **Three types of transactions were reviewed: (1) payments to contractors, (2) payments to grantees, and (3) other payments including those used to support First 5 administrative operations or to reimburse initiatives/programs for expenditures related to Medi-Cal Administrative Activities.**

- **In general, transactions reviewed were adequately documented. Amounts invoiced and paid were consistent with amounts allowed for the contractor or grantee in their executed agreements, and payments for all transactions were authorized by required staff signatures on Payment Authorization forms. However, the review found that program, contract compliance, and financial management controls over expenditures could use improvement.**

- **The transaction review showed that some grantees are spending in categories that do not match their approved grant agreement budget, or are submitting incomplete or inaccurate spending information. In cases where invoices and budgets differed, required paperwork authorizing the change was not on file with related documentation such as invoices, contract and grant agreements. Reporting associated with contractor invoices was inconsistent in terms of the level of detail included in both the contract's budget document and in the invoice. Not all contract budgets specified level of services or materials to be provided, and even fewer invoices specified level of services or materials provided during the payment term. Non-grantee and contractor payments often lacked supporting documentation that identified initiatives or programs associated with the expenditures, making it difficult to determine if the expenditures support general First 5 LA activities and/or initiatives/programs.**

- **Of the transactions reviewed, 49 percent of grantees and 21 percent of contractors in the sample did not submit their invoice within the required period, although First 5 LA provided payment for these invoices within the required period. Invoices that were not submitted on time were between one and four months late.**

Methodology

In order to validate First 5 LA's procedures and controls for processing and recording expenditures and financial transactions that result in changes to the agency's reserves and available funds, a review was conducted of First 5 LA's accounting system reports, ledgers and contract records and a sample of actual transactions from between June 30, 2010 and February 28, 2011. A total of 68 expenditure transactions were reviewed to determine the following:

1. Was the transaction accurately recorded?
2. Was the transaction consistent with applicable laws, Commission policies and procedures, and relevant accounting standards?
3. For payments to grantees and contractors, was the transaction consistent with the terms of their contracts, particularly regarding payment schedule and amounts?
4. Was the transaction, or governing agreement, approved by First 5 LA's Board of Commissioners, where required, or was it associated with a contract that was approved in accordance with applicable laws and Commission policies and procedures?

For this review, 58 transactions were initially selected for review using a stratified random sample of all expenditure transactions that have caused, or should have caused changes in First 5 LA's reserves and took place between June 30, 2010 and February 28, 2011[1]. Because the initial random stratified sample did not include any high dollar value transactions of over $100,000, a judgmental sample was added of ten expenditure transactions with values of over $100,000 each, were added to the sample for a grand total of 68 transactions reviewed. A summary of the transactions reviewed is shown in Exhibit 2.1

[1] The sample consisted of 68 transactions in order to ensure a 95 percent confidence level. A confidence level of 95 percent indicates that the sample reflects the population with 95 percent certainty.

Exhibit 2.1: Profile of Sample Transactions Reviewed

	Grants		Contracts		Admin/Other		Total	
Program	**#**	**$ Amount**	**#**	**$ Amount**	**#**	**$ Amount**	**#**	**$ Amount**
Baby Friendly Hospital Project			1	$4,836			1	$4,836
Best Start LA			3	45,022			3	45,022
Black Infant Health	1	9,092					1	9,092
Community Opportunity Fund (COF)	11	66,835					11	66,835
Early Childcare and Education Workforce Development							0	0
Family, Friends and Neighbors (FFN)	2	27,374					2	27,374
Family Literacy Expansion	1	9,751					1	9,751
Family Place Libraries			1	336			1	336
Healthy Births	2	82,747					2	82,747
Healthy Kids			2	369,216			2	369,216
Los Angeles Universal Preschool (LAUP)			1	135,874			1	135,874
Oral Health Community Development			1	8,359			1	8,359
Oral Health/ Nutrition Expansion	1	7,302					1	7,302
Organizational Assessment Design and Implementation			1	16,385			1	16,385
Partnerships for Families (PFF)	7	725,782	2	204,050			9	929,831
School Readiness	12	763,103					12	763,103
Technical Assistance			1	1,449			1	1,449
Workforce Development	4	142,416					4	142,416
Uncertain/ Unspecified			6	39,597	8	15,569	14	55,166
TOTAL	**41**	**$1,834,403**	**19**	**$825,123**	**8**	**$2,675,095**	**68**	**$2,675,095**

Source: First 5 LA transaction records, grantee and contractor agreements and invoices.

Overview of Transaction Review Results

As shown in Exhibit 2.2, three types of transactions were reviewed: (1) payments to grantees; (2) payments to contractors; (3) payments supporting First 5 LA's administrative operations and payments to reimburse initiatives/programs for expenditures related to Medi-Cal Administrative Activities (MAA) that, together, are referred to as "Admin/Other" in this section of the report.

The review showed that amounts invoiced and paid to grantees and contactors were consistent with the total amounts encumbered for each grantee's or contractor's executed agreements in effect during the billing period and did not exceed the amount available in Board of Commissioner-approved allocations for their respective initiatives/programs. Any adjustments to reserves resulting from the expenditures reviewed would not have resulted in encumbrances or reserves exceeding previously approved or reported amounts. Required signatures were found for all invoices reviewed indicating that required approvals had been obtained before payments were made.

However, some absences in program, contract compliance and financial management controls were identified in this review of 68 expenditure transactions including: (a) lack of compliance with First 5 LA's requirement that all grantee and contractor agreements include a detailed line-item budget detailing planned expenditures; (b) inconsistent detail about costs and services between some grantee and contractor budgets and invoices; (c) numerous invoices submitted after the First 5 LA cutoff date for the month. In addition, none of the documentation supporting First 5 LA's administrative operations specified an association with a specific initiative/program. Taken together, the absence of controls in these areas could affect the accuracy of identified reserves for allocations and/or initiatives/programs. They also represent management improvements needed to ensure that all funds are being used consistent with the agency's mission, policies and procedures approved by the Board.

Exhibit 2.2 below summarizes the results of the transaction review.

Exhibit 2.2: Transaction Review Results

Transaction Type	# of Transactions in Sample	Payment Amount Consistent with and Did Not Exceed Agreement or Contract	# of Transactions with Consistent Detail: Budget versus Invoice	Invoice Not Submitted within 20 Days of Prior Month
Grant	41	41	17	20
Contract	19	19	14	4
Admin/Other	8	8	n/a	1
Total	**68**	**68**	**31**	**25**

Source: First 5 LA expenditure transactions records, grantee and contractor agreements and invoices.

Grantee Transactions

As shown in Exhibit 2.2, 41 of the transactions in the sample were payments made to grantees, which included representation from the following initiatives/ programs:

- Community Opportunity Fund (COF)
- Early Childcare and Education (ECE) Workforce Development
- Family Literacy Expansion

- LA Best Babies Network (Healthy Births)
- Partnerships for Families (PFF)
- School Readiness

All grantees are required to submit monthly invoices to First 5 LA consistent with the line-item budgets included as part of their respective grant agreements. Signature approval by between one and three First 5 LA staff members is required before payment is made to grantees.

All grantee invoices reviewed had a format identical to the first page of the budget document in the grant agreement (Exhibit B in each agreement), which provides total spending by budget line items including Personnel, Contracted Services, Materials and Supplies, Evaluation, and Indirect Costs. On the invoice document grantees are required to identify their actual expenditures by budget line item for the billing month, as well as the year-to-date total, approved budget, and budget balance. Invoiced amounts reviewed for each grantee invoices were within the annual budget authorized in each grantee's agreement. Payments for all grantee payments reviewed were authorized by signatures on Payment Authorization forms, as required in the *First 5 Los Angeles Finance Department Accounting Policies and Procedures* manual.

In all grantee invoices reviewed, individual expenditure amounts accurately added up to the total amount invoiced and corresponding payment issued by First 5 LA. However, in seven cases, the amounts invoiced in particularly expenditure categories were inconsistent with the amounts allowed in the Exhibit B budget. While the amounts invoiced did not exceed the total annual amount allowed for the year in each agreement, the amounts allowed for specific line items such as Personnel Costs, Materials and Expenses on invoices exceeded the amounts allowed in the Exhibit B budgets.

According to the standard grant agreement, which contains the same budgetary reporting requirements for all grantees, expenditures must be in accordance with the approved line item in the Exhibit B budget. Grantees may modify line items but must submit a Memorandum to First 5 LA staff if the modified line item is equal to or less than $5,000, or 10 percent of the original line item. If the modified line item is more than $5,000 or 10 percent of the original line item, the grantee must obtain approval of a Formal Budget Modification form. The required memoranda or Formal Budget Modification forms for these seven cases were not on file with other financial documentation such as invoices, contract and grant agreements. Although the total budget did not change as a result of these line item differences, insufficient or unavailable documentation for line item changes suggests that First 5 LA staff may not always be aware of changes in the intended use of First 5 LA funding, or that documentation of line-item changes to the approved budget is not obtained by staff and filed in a timely manner.

For 17 of the 41 grantee invoices reviewed, or 41 percent of the sample, the Exhibit B budget contained itemized amounts for one or more expenditure categories but no such itemized detail was located in the invoice. In several cases, grantees provided itemized detail for personnel, but did not submit their spending detail for materials, supplies, or contracting services.

Finally, all grantees are required to submit invoices by the 20th business day of each month for the previous month. Twenty of the 41 grantees in the sample, or 49 percent, did not submit their invoice within the required period but were still paid. Invoices that were not submitted on time ranged from between one and four months late. This indicates that program staff overseeing grantees and Finance Department staff are not ensuring adherence to the invoice cutoff date.

Contractor Transactions

Of the sample 68 expenditures reviewed, 19 were payments to First 5 LA contractors. Exhibit 2.3 presents the distribution of contractors by program/initiative and shows the value of the expenditures reviewed in this sample.

Exhibit 2.3: Contractor Transaction Review Results

Initiative/ Program	# of Contractors	Total Payment Amount
Baby Friendly Hospital Project	1	$4,836
Best Start LA	3	45,022
Family Place Libraries	1	336
Healthy Kids	2	369,216
Oral Health Community Development	1	8,359
Organizational Assessment Design and Implementation	1	16,385
Partnerships for Families	2	204,050
Technical Assistance	1	1,449
Los Angeles Universal Preschool	1	135,874
No initiative or program specified	6	39,597
TOTAL	19	$825,123

Source: First 5 LA expenditure transactions records, contractor agreements and invoices.

As with grant agreements, First 5 LA practice calls for contractor expenditures to be in accordance with an approved line item budget included in each contractor's agreement (the Exhibit B budget). However, of the 19 contractors for whom payments were reviewed in our sample, agreements for only 15 contractors included Exhibit B budgets that identified levels of service or supplies based on (a) hourly rates and number of hours of service designated, (b) units of service provided, or (c) units of supplies provided. The other four agreements did not specify service levels or include a line item budget. Payments for all contractor payments reviewed were authorized by signatures on Payment Authorization forms, as required in the *First 5 Los Angeles Finance Department Accounting Policies and Procedures* manual.

In spite of the First 5 LA practice calling for contractor agreements to include an expenditure budget, invoices for only 10 of the 19 contractor payments reviewed provided cost detail relative to a pre-approved budget. Of the remaining nine contractors, four did not have a budget in their agreement, as mentioned above, and another five had invoices that either did not include itemized expenditure detail, though their agreements included a line-item budget, or had itemized detail that differed from the categories in their Exhibit B budget. A number of these nine invoices did not specify what services or supplies they had provided.

Eight of the contractor invoices reviewed did not specify which First 5 LA initiative/program was associated with the goods or services provided. Invoices for the other 11 contractors were associated with the following initiatives/programs:

- Baby Friendly Hospital Project
- Best Start
- Family Place Libraries
- Healthy Kids
- Oral Health Community Development
- Partnerships for Families (PFF)
- Los Angeles Universal Preschool

One instance was identified where a contractor violated the terms of the Exhibit B budget by charging $101.50 per hour for services, when the hourly rates for services specified in the contract ranged from $55 to $100. While this is a small amount and does not appear material, the invoice was paid anyway indicating that, in at least one instance, program, contract compliance, and finance management controls were not sufficient. It should be noted that while a rate charged exceeded approved rate amounts, the total amount of the agreement for this contractor was not exceeded by this payment.

Finally, as with grantees, contractors are required to submit invoices by the 20th business day of each month for the previous month. The review of contractor transactions revealed that four of the 19 contractors in the sample, or 21 percent, did not submit their invoice within the required period. Invoices that were not submitted on time were between one and two months late.

Administrative/Other Expenditures

Of the 68 transactions reviewed, eight payments were not made to grantees or contractors. These payments included: (a) reimbursements made to grantees eligible for Medi-Cal Administrative Activities (MAA) reimbursements; (b) credit card payments for First 5 LA staff expenses; (c) a payment for office supplies associated with a First 5 LA marketing initiative; and, (d) reimbursements for First 5 LA expenditures booked to the Communications and Research and Evaluation allocations.

The amounts paid were consistent with invoice documentation, which was comprised of credit card bills, MAA reimbursement lists, an invoice, and email correspondence. Payments for all administrative/other expenditures reviewed were authorized by signatures on First 5 LA's Payment Authorization forms. However, with the exception of the MAA reimbursements, supporting documentation for these transactions did not identify which specific initiatives/ programs were associated with the expenditures, making it difficult to understand how the money spent relates to First 5 LA budgeting or programming. For example, expenditures charged to Communications might have been used for general First 5 LA activities, for activities associated with a specific initiative/ program such as School Readiness, or to support multiple programs. First 5 staff advised that the Board of Commissioners Ad Hoc Committee is exploring how staff could better document these expenses. Regardless of whether the expenditure supports one or multiple uses, a policy should be adopted whereby First 5 staff documents how all transactions are used to support the Operating Budget or agency initiatives/ programs.

Conclusions

A review of a sample of 68 transactions and corresponding contracts that contributed to changes in First 5 LA's reserves and balances available between June 30, 2010 and February 28, 2011 shows that most transactions were adequately reviewed and accurately recorded by First 5 LA staff. Amounts invoiced and paid were consistent with amounts allowed for the contractor or grantee in their executed agreements in effect during the billing period, and payments for all transactions were authorized by signatures of First 5 LA staff.

However, documentation submitted by contractors and grantees, as well as compliance monitoring conducted by First 5 staff could use improvement. Some grantees submitted invoices listing spending in budget line items that did not match the line item amounts approved in their grant agreement budget, or submitted incomplete or inaccurate spending information in their invoices. In cases where amounts in the invoice differed from amounts in the approved budget, documentation of the change, or approval of the change if above $5,000, was not found.

Reporting associated with contractor invoices was inconsistent in terms of the level of detail included in both agreement budget documents and invoices. Not all budgets in the agreements specified level of service or supplies to be provided, and even fewer invoices specified level of services or supplies provided during the payment term. Finally, non-grantee and contractor transactions often did not have documentation on file that identified the initiatives/programs associated with the expenditures, making it difficult to understand if expenditures support general First 5 LA activities or specific initiatives/programs and to determine if the expenditures affected encumbered or other reserved amounts.

Recommendations

The First 5 LA Board of Commissioners should:

2.1 Direct management to report back on new procedures and controls in place to ensure that First 5 LA staff monitors grantees and contractors to ensure compliance with financial reporting policies which state that grantees and contractors must submit invoices that demonstrate spending in accordance with the line-item budgets approved in each contract or agreement.

2.2 Implement a policy that requires that all contractors submit budgets and invoices that specify the units of goods or specific service to be provided during the contract term.

2.3 Implement a policy to ensure contractors consistently specify the initiative/program, or internal First 5 LA department associated with each invoice submitted.

Costs and Benefits

Implementation of all recommendations should be accomplished using existing resources. By monitoring grantee and contractor compliance with reporting requirements, the First 5 Board of Commissioners and staff will benefit from financial transparency and an improved understanding of how First 5 LA funds are spent.

3. Accounting for Reserves, Designations and Fund Balance

- **Reserves and designations of fund balance for First 5 LA programs are derived from allocations authorized by the First 5 LA Commission. However, the accounting process for tracking and monitoring allocations, reserves and designations of fund balance has several weaknesses, including: (1) lack of procedural consistency in the use of spreadsheets and manual calculations to determine reserved and unreserved fund balance amounts; (2) lack of controls over allocation amounts; (3) lack of monthly reconciliations between amounts reported and financial records; and, (4) absence of written policies and procedures for agency financial processes.**

- **Total fund balance is estimated to have been approximately $925,391,252 as of February 28, 2011, though a complete reconciliation of agency accounts and financial transactions is needed to verify this amount. First 5 LA does not maintain an accounting month to month of fund balance and associated allocations, reserves and designations. Variances identified during reconciliation of accounts and transactions prevented our verifying reserves and fund balance components as of February 28, 2011. For example, reconciliations showed the remaining balance in eight allocations to be insufficient to cover total reserves for those programs/initiatives.**

- **Despite procedural challenges, the Finance Department should be recognized for its ability to manually track and identify accounting transactions and process accounting exceptions in detail. Numerous requests by project staff for explanation of accounting variances were addressed quickly and thoroughly. By addressing accounting process weaknesses and shifting to quarterly financial status reports, management and Finance Department staff would realize greater efficiency and be better equipped to provide improved financial information to the Board. An assessment of agency tools and resources needed, if any, to address these issues was not conducted as part of this procedures engagement.**

- **First 5 LA management should develop and implement agency-specific written policies and procedures to clarify and strengthen accounting processes and controls regarding allocations, reserves, and designations and conduct formal reconciliations quarterly for financial reports to the Board.**

- **Sufficient data and information is known about reserves and designations for the Commission to determine how to prioritize funding in the event that it must remit $424,388,705 to the State pursuant to Health and Safety Code Section 130158.**

Fund balance, or the difference between an organization's assets and liabilities, is a measure of the amount available for an organization to spend in the future. Fund balance is comprised of: (1) funds reserved for specific purposes, such as funds encumbered for approved contracts; (2) funds that are unreserved but designated by the governing body or management for certain future uses; (3) funds that are unreserved and undesignated, or generally available for appropriation. Fund balance is an important metric for a governing body to understand their organization's current financial position and to enable planning for the short- and long-term programs and spending.[1]

The reserve and designation components of First 5 LA's fund balance are derived from allocations authorized by the First 5 LA Board of Commissioners (Board). Once an allocation is established by the Board for one of its programs or initiatives, the funding is considered unreserved but designated for said purpose. Designated funding is predominantly expended through a contracting process and, as contracts are executed, the contract amount is considered reserved (or encumbered) because there is a legal obligation for expenditure. Without a fully executed contract, First 5 LA funds are not classified as encumbered but may be considered reserved for obligations, if the Board has explicitly authorized and directed staff to enter into an agreement with a specified agency. The latter amount is not reserved in the strictest sense of the word (i.e., there is no legal restriction on the funds such as an executed contract) and could be appropriated for other purposes by the governing board. As contracts are spent down, reserve balances for encumbrances decrease. One exception is for matching grants wherein the full allocation is reserved regardless of contract status because the entire amount must be spent in order to meet grant requirements.

As part of its unreserved fund balance, First 5 LA designates funds for operating purposes, including designations for Operating Sustainability, the annual Operating Budget and Local Initiatives. These funds are not legally obligated and could be used for other purposes, subject to Board approval. The remainder of the agency's unreserved fund balance is classified as undesignated.

In addition to compiling all expenditures, contracted amounts and other designations for First 5 LA's Comprehensive Annual Financial Report (CAFR), the agency's Finance Department also compiles allocation, reserve and designation balances, using a variety of spreadsheets and manually prepared reports, for the Monthly Financial Reports provided to the Board, as discussed in Section 1 of this report. Because these are monthly reports, the Finance Department compiles expenditures for each allocation by reviewing expenditures and other transactions recorded in the agency's financial system, identifying them by account and manually assigning them to a program/initiative allocation. These monthly expenditures are added to a cumulative total for the year and for each program/initiative allocation since inception (most allocations are multi-year). Allocation balances are the basis for First 5 LA reserves and designations.

As of June 30, 2010, First 5 LA's fund balance was allocated as follows:

[1] GASB 54 will revise fund balance classifications from reserves and designations to a new classification structure. While the perspective will change – from one of that defines the availability of fund balance for appropriation to one that defines the underlying source of the fund balance - the nature of, and restrictions on, fund balance are essentially the same.

Exhibit 3.1: Allocation of First 5 LA Fund Balance as of June 30, 2010

Fund Balance	Amount
Reserved for:	
Encumbrances	$ 129,094,693
Obligations	189,699,943
First 5 California Initiatives	19,004,928
Subtotal Reserves	337,799,564
Unreserved, Designated for:	
Operating Sustainability	7,571,923
Operation Budget	12,709,972
Local Initiatives	229,593,277
Subtotal Desingations	249,875,172
Unreserved and Undesignated	261,102,674
Total Fund Balance	$ 848,777,410

Source: First 5 LA FY 2009-10 Comprehensive Annual Financial Report (CAFR)

Accounting Process Weaknesses

The accounting process for tracking and monitoring allocations and reserves and designations of fund balance has several weaknesses, including:

(1) lack of procedural consistency in the use of spreadsheets and manual calculations to determine reserved and unreserved fund balance amounts;

(2) lack of controls over allocation amounts;

(3) lack of monthly reconciliations between amounts reported to the Board and agency financial records, and;

(4) absence of written policies and procedures for agency financial processes.

Manual Process

At year-end, the Finance Department compiles the fund balance components of reserves, designated and undesignated balances for the annual financial statements and independent financial audit (Comprehensive Annual Financial Report, or CAFR) using numerous spreadsheets with data and other information from the accounting system, the contract management system, and historical reports of allocation balances and cumulative expenditures. Much of this accounting process is a labor intensive and inefficient manual process that cannot be easily be replicated for monthly financial reporting. In general, manual accounting processes are prone to human error, especially if not guided by written policies and procedures or reconciled and validated in some manner.

To review and validate the First 5 LA accounting processes and procedures for compiling fund balance reserves, designations and unreserved amounts, we reviewed agency supporting documentation for the amounts presented in the Comprehensive Annual Financial Report (CAFR) as of June 30, 2010. Supporting documentation was a series of spreadsheets that were manually prepared, some of which were incomplete. Support was not provided reconciling reported expenditures with amounts recorded in the agency's accounting system. Review of the June 30, 2010 supporting documents did identify several errors, including a $1,000,366 Urban Institute contract that was reported as a reserve in both the Best Start and the Research and Evaluation allocations, thus overstating total reserves for encumbrances in the CAFR.[2] In summary, the year-end process relied upon manual compilation of financial data and information derived from multiple sources, but which was not thoroughly documented in a comprehensive set of workpapers that could be readily transmitted upon request by the project team.

In response to a proposal by the Governor of California to take away part of reserves from First 5 agencies in every county in California, First 5 LA staff prepared an estimated of the agency's reserves and fund balances for the Board, as of February 28, 2011. However, because of its highly manual accounting process, a full reconciliation of accounting records and compilation of fund balance as of February 28, 2011 consistent with reported fund balance as of June 30, 2010 could not be completed for the Board. Rather, Finance staff updated only outstanding contract balances to determine the reserve for encumbrances amount as of February 28, 2011, leaving out adjustments currently only done at year-end. Thus, the Board was not presented a full accounting of allocations, expenditures, reserves, designations, and fund balances as of February 28, 2011. However, a reconciliation was conducted as part of this procedures engagement and is presented below. Through this manual reconciliation process, a number of exceptions were noted that should have generated adjustments to the amounts presented.

Despite these procedural challenges, the Finance Department should be recognized for its ability to manually track and identify accounting transactions and process accounting exceptions in detail. First 5 LA's allocations, discussed further below, and associated reserves and designations are complex. Numerous requests by procedures engagement project staff for explanation for identified accounting variances were addressed quickly and thoroughly. In order to better communicate this understanding, the Finance Department should formalize its manual processes by developing written policies and procedures that link financial reporting to accounting records and documents and that minimize accounting variances and exceptions.

[2] The agency's independent auditor did not make an adjusting journal entry for this item, presumably because it was below the materiality threshold.

Allocations as a Control

While allocations are authorized by the Board, the agency's management and Finance Department staff have difficulties in some instances understanding Board actions in this regard, defining allocation specifications, and establishing allocations as a financial accounting control mechanism. Much of this difficultly stems from the absence of clear processes for providing financial and budgetary information to the Board and recording Board actions, as discussed in Section 1 of this report.

The ambiguity surrounding approval of and changes to allocations by the Board has resulted in some designations being distorted. Expenditures and contracts can meet criteria for different allocations and can be and have been shifted among allocations for funding purposes. In fact, for one grantee, expenditures were posted to two different programs in the accounting system and were then reflected in a third program for the reporting of fund balance and reserves as of February 28, 2011. Finance Department staff report that they have not determined where the contract and expenditures should be charged and will likely move the contract and associated expenditures to another program, but didn't specify which program.

Implementation of the FY 2009-2015 strategic plan has only confused allocations more by establishing new allocations with similar purpose but different titles and not clearly defining time periods. Old allocations have not been closed with their residual balances reverting to the undesignated fund balance. Rather, the old allocations are being spent down before new allocations are used. Further, Finance Department staff account for and report on all programmatic transactions as though they offset allocations even though there may not have been an established allocation for each expenditure or other transaction.

While the Finance Department should implement and enforce allocations as a control mechanism, the Department is dependent upon leadership and executive management to facilitate a control environment wherein this is possible. Written accounting policies and procedures should be developed that establish allocations as a financial control and should include:

- a clear definition of an allocation and how it is different than an appropriation;
- how and when to establish and close out allocations;
- processes to track, monitor and report on allocations;
- a process to return to the Board in advance for appropriating additional resources if an allocation is going to be overspent; and,
- other parameters regarding the use of allocations.

Not all programmatic expenditures are necessarily required to be charged against an allocation, but there does have to be appropriation authority approved by the Board. This should occur during an annual budget process during which the Board also designates an annual updated appropriation for allocations, in addition to a designation for allocations for the duration of the current strategic plan.

Reconciliation

An important component of internal control is reconciliation of an organization's accounts and financial transactions.[3] Reconciliations ensure that transactions are classified correctly and identify errors or required adjustments in a timely manner. During the course of this procedures engagement, several reconciliations were completed by the project team including a reconciliation of allocation, reserve and designation balances with FY 2010-11 expenditures as of February 28, 2011. These reconciliations identified a number of adjustments to account balances as well as weaknesses within the accounting and reporting processes that are detailed throughout this section.

Further, a reconciliation of three randomly selected programs/initiatives - Best Start, Healthy Kids, and Partnership for Families - was conducted to ensure that transactions recorded in the agency's financial system were accurately captured and compiled in monthly and annual financial reports. For two of the three programs, the manual spreadsheets summarizing program transactions did not easily reconcile with the accounting system. While the Finance Department was able to provide supporting documentation and explanation for variances, the reconciliations required pulling data and information from different sources. Linking allocations with contracts and expenditures due to timing issues was difficult. The reconciliation also identified two contracts with expenditures totaling $37,067 and $117,333 that were posted to the incorrect allocations.

As noted above, the Finance Department is able to manually track and identify accounting transactions and process accounting exceptions in detail. However, the Finance Department lacks a methodical and formalized approach to reconciliation that would ensure that transactions are classified correctly and identify errors or required adjustments in a timely manner. A quarterly reconciliation would highlight issues as they arise and bring them to the Board's attention as early as possible, enable staff to identify and correct errors more timely and ensure consistency and continuity of reporting allocations, reserves, designations, and total fund balances. This is especially critical due to the manual nature of the agency's accounting and compilation process.

Policies and Procedures

In addition to a lack of written policies and procedures for allocations, First 5 LA does not maintain agency-specific written policies and procedures pertaining to fund balance, particularly reserves and designations. For example, there is no protocol for linking allocations with reserves and designations of fund balances nor is there a written explanation of First 5 LA's operating designations (i.e., Designated for Operating Sustainability, Designated for the Operating Budget,

[3] An organization's accounts refers to how an organization tracks and monitors its financial activities. For First 5 LA, this generally refers to the agency's allocations as well as its various operational and programmatic divisions.

etc.). The Finance Department relies on the Financial Management Guide created by First 5 California as well as Generally Accepted Accounting Principles (GAAP) for financial reporting. The Finance Department notes that the implementation of GASB 54 in accordance with GAAP will greatly increase First 5 LA's documented policies and procedures, and reduce management's discretion, with regard to the classification of the agency's fund balance.

While GAAP is changing reporting requirements for reserves and designations effective June 30, 2011, First 5 LA must still be able to bridge these high-level requirements with specific written policies and procedures for management reporting and internal accounting processes and controls. Again, the agency's own policies and procedures should define reserves and designations, required specifications and controls over use, and detail processes to track, monitor and report on reserves and designations of fund balance.

Reserves, Designations and Fund Balance as of February 28, 2011

The First 5 LA staff reported four financial measures to the Board that, together, amounted to a total fund balance as of February 28, 2011 of $925,391,252[4], (though the total fund balance amount was not included in the report). In calculation of fund balance, staff did not conduct procedures as they would typically do during the year-end closing process. Therefore, not all of the components of fund balance were presented in a similar format as in the annual financial statements.

Exhibit 3.2 presents the components of fund balance as of February 28, 2011 as reported to the Board. We have calculated "Total Fund Balance" by adding the four reported components together.

Exhibit 3.2: Fund Balance as of February 28, 2011, as Presented to the Board of Commissioners (1)

Fund Balance Components Presented	Amount
Reserved for Encumbrances	$ 144,306,276
Designated for Operational Budget	9,498,942
Designated for State "Takeaway"	424,000,000
Unreserved and Undesignated	347,586,034
Total Fund Balance Derived by Project Team	$ 925,391,252

Source: First 5 LA Fund Balance Projections as of February 28, 2011

(1) The four fund balance components showing in Exhibit 3.2 were presented to the Board of Commissioners if February 2011 in special staff reports presented to the Board in February 2011 but total fund balance was not presented. The total was calculated by the procedures engagement team by adding together the four fund balance components shown in Exhibit 3.2.

[4] This fund balance is presented on cash basis, which is different than the modified accrual basis used in the presentation of the Comprehensive Annual Financial Report. Therefore, this amount is not comparable to the $848,777,410 fund balance reported as of 6/30/10 on a modified accrual basis.

Most governmental and quasi-governmental agencies do not prepare financial statements on a monthly basis due to the time requirements and the use of estimates and assumptions that are vetted during the year-end closing and auditing process. Thus, consistent with industry practice, the February 28, 2011 reporting of fund balance was neither intended to be comprehensive nor intended to be comparable with the year-end financial statements.

Currently, financial reports are presented monthly to the Board which reduces their impact. Compilation of the reports from unreconciled data and information from the accounting system and other financial documents further reduces their usefulness. Consistent with best practices in governmental accounting and reporting, the Finance Department should shift its resources from preparing monthly financial reports to preparing comprehensive quarterly reports after reconciliation of agency accounts as detailed above.

In order to present fund balance in a similar format as presented in the agency's annual financial statements, a reconciliation of the Monthly Financial Report as of February 28, 2011 and Fund Balance Projections prepared by First 5 LA staff was completed by the project team, as shown in Exhibit 3.3. Using allocations as a control, our reconciliation identified several variances that required adjustments to the derived February 28, 2011 fund balance presented in Exhibit 3.2 of $925,391,252. Our reconciliation, presented in Exhibit 3.3 below, combined allocation balances with fund balance reserves identified by agency staff as of February 28, 2011 and presented to the Board in various reports. Our reconciliation showed that eight allocations are not sufficient to cover expenditures to date and amounts reserved for the future for their respective program/initiative.

As can be seen in Exhibit 3.3, the following eight allocations have a negative designated balance because contract obligations exceed unexpended allocation balances:

- 2-1-1 Line
- Early Childhood Education (ECE) – Friends, Families and Neighbors
- Family Literacy Expansion Grants
- Healthy Kids
- Medi-Cal Administrative Activities (MAA) – Los Angeles (LA) County
- Medi-Cal Administrative Activities (MAA) – Participation Payment
- Technical Assistance Institute (Strategic Plan)
- Consulting Services

As noted above, the negative designated balances are due to ambiguity in the agency's allocation process and are classified into the following three categories:

- Discrete allocations have been established but have been merged for expenditure purposes. Thus, the allocations are not clearly defined and controlled. The Finance Department reports that negative variances are offset by positive balances in other allocations. For example, the 2-1-1 Line allocation in Exhibit 3.3 has a negative balance of $982,555. The Finance Department reports that under the new strategic plan, these activities and associated contract are funded by the Information Resource Referral allocation.

- The full contract balance amount is not anticipated to be expended and therefore expenditures will be less than the total allocation amount (e.g., Healthy Kids).
- Funding is passed through from the Federal and State governments and the Finance Department reports that the way to account for the funding in the monthly financial reports could be improved (Medi-Cal Administrative Activities or MAA).

For all allocations, management must develop policies and procedures to use allocations as a control and this new framework should be presented to the Board to ensure not only that expenditures are accurately reported, but also to ensure that allocations are used as authorized by the Board.

For Healthy Kids, where the remaining allocation is $10.2 million short compared to the amount reserved for the program, the First 5 LA Finance Department reports that the contract is to cover health insurance of up to 15,000 children. However, the number of children actually covered by the contractor are historically significantly less and, therefore, management staff believe that the allocation in reality will never be met. However, because the Board, as the appropriating body, has only approved expenditures up to a set allocation, First 5 LA management has exceeded its authority to contract and obligate the organization for an amount in excess of what the Board has approved. The contract amount should be reduced to the historical level of actual expenditure not only to not exceed legally authorized levels, but also to not unnecessarily obligate funding which in reality is not expected to be expended.

Regarding Medi-Cal Administrative Activities (MAA), this funding is received from the Federal and State government to augment Medi-Cal and pay for associated administrative costs. All funding that is received is expended for program purposes, but the funding is not approved as an allocation by the Board. While the financial reports include an allocation of the portion of the funding paid to Los Angeles County, the allocation amount had not been updated for the current year in error resulting in an over-obligation of fund balance. Further, because there is no allocation related to the portion of funding paid to providers, total unexpended allocations are understated because this program is included. Consistent with other allocations and programs, the Board should review and authorize allocations for the MAA program in its entirety in order to track, monitor, control, and report on program activity.

Exhibit 3.3: Fund Balance Reserves and Designations When Allocations are used as Controls, as of February 28, 2011

Data Source	Monthly Financial Report				Agency Staff Calculation	HMR Calculation
	Total Allocation	YTD Actual	Cumulative Actual	Total Unexpended Allocation	Reserved	Designated
Multiple Year Programs, Initiatives, and Grants						
2-1-1 Line	$ 11,000,000	$ 831,706	$ 10,213,012	$ 786,988	$ 1,769,543	$ (982,555)
ARRA Funds TA	250,000	27,300	50,067	199,933		199,933
ARRA Matching	4,000,000	432,932	731,338	3,268,662	1,410,446	1,858,216
Best Start LA (P-3)	55,000,000	2,939,707	10,960,991	44,039,009	7,604,399	36,434,610
Black Infant Health	5,809,930	374,112	1,508,213	4,301,717	768,578	3,533,139
Children's Planning Council - SP II	4,250,000	304,005	3,071,465	1,178,535	575,995	602,540
Community Opportunities Fund	13,200,000	1,250,930	4,815,227	8,384,773	2,878,372	5,506,401
Conference Sponsorship	154,137	62,750	62,750	91,387		91,387
Cross Cutting Approaches (GM R&E)	3,317,160	25,487	3,196,116	121,044		121,044
Early Childhood Education (4 Yr Olds)	580,000,000	(90)	272,377,830	307,622,170	52,837,099	254,785,071
ECE - Family, Friends and Neighbors	4,583,722	580,887	3,964,609	619,113	640,574	(21,461)
ECE Workforce Development	6,547,029	846,212	4,350,286	2,196,743	1,071,404	1,125,339
Family Literacy Expansion Grants	20,278,341	1,108,155	19,056,497	1,221,844	1,443,200	(221,356)
Healthy Kids	100,000,000	3,390,375	96,147,450	3,852,550	14,274,533	(10,421,983)
LA Best Babies Network (Healthy Births/Expansion)	29,244,627	1,916,847	26,737,307	2,507,320	2,504,570	2,750
La Petite Academy	49,803	-	49,803	-	-	-
MAA - LA County	287,716	18,851	306,567	(18,851)	-	(18,851)
MAA - Participation Payment	-	240,406	1,266,701	(1,266,701)	-	(1,266,701)
MRMIB	2,446,368	-	2,446,368	-	-	-
Oral Health Community Development	13,100,000	14,525	1,219,438	11,880,562	752,294	11,128,268
Oral Health/Nutrition Expansion	16,900,000	357,335	2,440,549	14,459,451	954,413	13,505,038
Partnership for Families	53,413,279	5,258,133	46,162,606	7,250,673	6,053,260	1,197,413
Performance Based Contract (Altmayer)	149,159	21,435	104,210	44,949	3,455	41,494
Public Education (PA)	10,258,768	239,432	8,583,669	1,675,099	917,191	757,908
Research and Evaluation	35,000,000	1,218,917	12,443,733	22,556,267	3,776,089	18,780,178
Research and Evaluation (Early Learning)	20,000,000	907,645	10,955,109	9,044,891		9,044,891
Technical Assistance Institute (Strategic Plan)	450,058	52,424	375,225	74,833	283,606	(208,773)
Implementation Planning Activities (Strategic Plan)	500,000	23,910	416,801	83,199	13,442	69,757
Research and Evaluation	2,769,250			2,769,250		2,769,250
Workforce Development	3,000,000	702,500	702,500	2,297,500	2,297,475	25
Cal-Works 3 Funding	15,000,000	4,642,540	4,642,540	10,357,460		10,357,460
First 5 California Initiatives - School Readiness	230,516,569	11,955,674	201,313,651	29,202,918	29,202,918	-
First 5 LA Operating Designations						
FY 10/11 Operating	17,685,821	8,186,879	8,186,879	9,498,942		9,498,942
Operation Sustainability	7,571,922	-	-	7,571,922		7,571,922
New Strategic Plan - Countwide Investments						
Public Policy	2,000,000	1,868	1,868	1,998,132		1,998,132
Public Education	1,150,000			1,150,000		1,150,000
Resource Mobilization	11,000,000			11,000,000	25,000	10,975,000
Workforce Development	3,000,000			3,000,000		3,000,000
Data Systems Integration	200,000			200,000		200,000
Health Access	9,650,000			9,650,000		9,650,000
Information Resource and Referral	2,196,183			2,196,183		2,196,183
Transition	5,100,000	26,144	26,144	5,073,856		5,073,856

Continued on next page

Exhibit 3.3 - Continued

Data Source	Monthly Financial Report				Agency Staff Calculation	HMR Calculation
	Total Allocation	YTD Actual	Cumulative Actual	Total Unexpended Allocation	Reserved	Designated
New Strategic Plan - Place-Based Investments						
Partnership Development Process	10,303,500	156,266	156,317	10,147,183		10,147,183
Community Capacity Building	3,545,000	107,387	107,387	3,437,613	5,356	3,432,257
Data Systems Integration	200,000			200,000		200,000
Public Education	1,550,000			1,550,000		1,550,000
Transition	1,700,000	34,225	34,225	1,665,775	394,023	1,271,752
Countywide Augmentation						
Consulting Services	-	32,721	32,721	(32,721)	13,812	(46,533)
East LA College Child Care Providers	1,057,952			1,057,952		1,057,952
Tot Parks and Trails	10,000,000			10,000,000		10,000,000
Infant Safe Sleeping	1,500,000			1,500,000		1,500,000
Connecting Risk and Perinatal Services	200,000			200,000		200,000
Data Partnership with Funders	5,000,000			5,000,000		5,000,000
ECE Workforce Consortium	37,079,667			37,079,667		37,079,667
Peer Support Groups for Parents	2,200,000			2,200,000		2,200,000
Substance Abuse Services	15,000,000			15,000,000		15,000,000
Healthy Food Access Initiative	7,500,000			7,500,000		7,500,000
Nutrition and Physical Activity Environment	6,197,400			6,197,400		6,197,400
Nutrition and Reduce the Obesity Epidemic	35,000,000			35,000,000		35,000,000
Parent Child Interactive Therapy	20,000,000			20,000,000		20,000,000
Community Family Hubs/ Family Literacy	13,100,000			13,100,000		13,100,000
One Step Ahead	30,000,000			30,000,000		30,000,000
Universal Assessment of Newborns	54,100,000			54,100,000		54,100,000
Totals	$ 1,556,263,361	$48,290,522	$759,218,169	$797,045,192	$ 132,471,047	$664,574,145

Source: First 5 LA Monthly Financial Report and Fund Balance Projections as of February 28, 2011.

Expenditure Reconciliation

A number of variances were identified that pertain to reported expenditures. For example, for the CalWorks 3 allocation, the Monthly Financial Report for February 28, 2011 reports a total remaining allocation balance of $10,357,460 due to a $4,642,540 expenditure in January 2011 while the February 28, 2011 Fund Balance Projections prepared by agency staff reported a total remaining reserve of $15,000,000. According to the Finance Department, the $4,642,540 is anticipated to be reimbursed from various grantees due to funding received subsequently from the State and, therefore, the expenditure was only a temporary bridge loan. While this issue is only a timing difference, it is reported differently as of the same time period and has resulted in an error in the compilation of fund balance. While the reserve was increased by the $4,642,540 in the projection of fund balance, the transaction was not removed from the expenditure total. Thus, the total February 28, 2011 fund balance amount reported to the Board was understated by this amount.

Conversely, no FY 2010-11 expenditures are reported as of February 28, 2011 for Early Childhood Education (Los Angeles Universal Preschool or LAUP). LAUP receives advances throughout the year and, according to the Finance Department, expenditures against these advances are not reconciled and posted until year-end. As of December 31, 2011, these expenditures totaled $23,901,630. First 5 LA has not determined LAUP expenditures for January and February, 2011. Thus, expenditures have been understated, and the February 28, 2011 reserve amount and fund balance have been overstated, by $23,901,630 plus two additional months of LAUP expenditures.

Assessment of Fund Balance as of February 28, 2011

Because of the reconciliation issues discussed above, total fund balance as of February 28, 2011 cannot be definitively established with certainty without an extensive reconciliation of agency records. Further, management presentation of fund balance to the Board as of February 28, 2011 did not present fund balance components consistent with the annual financial statement presentation. Rather, management presented only Reserves for Encumbrances and Designations for the Operating Budget. As shown in Exhibit 3.2, all remaining fund balance was reported by the Finance Department as either earmarked for the "State Takeaway" or as Unreserved and Undesignated.

Based on the reconciliation presented in Exhibit 3.3, the components of fund balance as of February 28, 2011, have been calculated by the project team and are presented in Exhibit 3.4 below.

Exhibit 3.4: HMR Presentation of Fund Balance as Determined by Agency Staff, as of February 28, 2011

Fund Balance	Amount
Reserved for:	
Encumbrances	$ 103,268,129
Obligations	-
First 5 California Initiatives	29,202,918
Subtotal Reserves	132,471,047
Unreserved, Designated for:	
Operating Sustainability	7,571,922
Operation Budget	9,498,942
Local Initiatives	647,503,281
Subtotal Desingations	664,574,145
Unreserved and Undesignated	128,346,060
Total Fund Balance	$ 925,391,252

Source: Compiled from the Monthly Financial Report and Fund Balance Projections as of February 28, 2011.

While this table has been compiled to present fund balance in a format similar to the annual financial statements, These amounts have not been adjusted to account for variances and recommended adjustments discussed above. Further, a more extensive reconciliation of agency accounts may identify additional required adjustments. Such adjustments individually and overall may have a material impact on each component of fund balance as well as the total estimated fund balance of $925,391,252. Therefore, while these amounts may be used to gain a general understanding of the agency's financial position as of February 28, 2011, these amounts should not be relied upon to take specific actions. Rather, the Board should rely upon the audited financial statements as of June 30, 2011. Beyond that, quarterly reconciliations should be conducted to allow for more reliable reporting of fund balance and its' key components: reserves; unreserved designations; and unreserved undesignated funds.

Remittance of Fund Balance to the State

Pursuant to California Health and Safety Code Section 130158, First 5 LA is currently required to remit to the State 50 percent of total fund balance as of June 30, 2010. Based on an audited fund balance of $848,777,410, First 5 LA remittance in FY 2011-12 would be $424,388,705. As shown below, $792,920,205 is available to cover this cost, or the difference between estimated fund balance of $925,391,252 and reserves for encumbrances and First 5 California initiatives ($103,268,129 and $29,202,918, respectively).

Assuming that the derived First 5 LA Finance staff estimate of total fund balance as of February 28, 2011 of $925,351,252 is materially correct, undesignated, unreserved fund balance would have been approximately $128,346,060. Thus, the fund balance components by which the Board could have drawn upon to meet this requirement are as follows as of February 28, 2011 would have been:

Undesignated, Unreserved Fund Balance	$128,346,060
Designated for Operating Budget[5]	$9,498,942
Designated for Operating Sustainability	$7,571,922
Designated for Local Initiatives:	
– Old Strategic Plan/ Multi-Year Programs and Other	$358,770,432
– New Strategic Plan/Place-Based and Countywide	$50,844,363
– Countywide Augmentation	$237,888,486
Total Unreserved Fund Balance Available for Reallocation	$792,920,205

Note: The Total Unreserved Fund Balance of $792,920,205 is comprised of total estimated fund balance of 925,391,252 less the amounts reserved for encumbrances and First 5 California initiatives ($103,268,129 and $29,202,918, respectively)

California Health and Safety Code Section 130158 also provides County Commissions the opportunity to terminate contracts and release Reserves for Encumbrances at their discretion. However, by the end of the fiscal year, most of the reserves for encumbrances will be expended as contract terms for grantees generally terminate annually at June 30.

[5] Governmental agencies do not typically designate fund balance generated in prior years for operating and administrative costs. Rather, these types of costs are typically paid for from current year revenues. Thus, such a designation is unnecessary.

However, as noted above, the Board should review and rely upon fund balance and its components as of June 30, 2011 after the Finance Department reconciles the agency's accounts and the financial statements are subjected to the annual independent financial audit.

Conclusions

First 5 LA accounting process for tracking and monitoring allocations, reserves, and designations of fund balance has several weaknesses, including: (1) lack of procedural consistency in the use of spreadsheets and manual calculations to determine reserved and unreserved fund balance amounts; (2) lack of controls over allocation amounts, (3) lack of monthly reconciliations between amounts reported and financial records; and, (4) absence of written policies and procedures for agency-financial processes.

Therefore, First 5 LA does not maintain a complete accounting month to month of fund balance and associated allocations, reserves and designations. Variances identified during reconciliation of various accounts and transactions not only highlight these weaknesses, but also prevent establishing definitively fund balance as of February 28, 2011 with existing reports and documentation provided by management. By shifting the account reconciliation process from an annual basis to a quarterly basis and commensurately shifting the financial reporting focus from a monthly basis to a quarterly basis, First 5 LA would improve its ability to track and monitor fund balance and its financial status.

Recommendations

The First 5 LA Board of Commissioners should:

3.1 Direct management to develop agency-specific written policies and procedures for (1) manual compilations of financial information, (2) allocations, reserves, and designations, and (3) quarterly reconciliations. Such policies and procedures should include adequate financial controls over the use of allocations.

3.2 Direct management to conduct formalized and methodical quarterly reconciliations and compilations for financial reporting purposes that account for timing differences and required adjustments to better reflect financial status.

3.3 Direct management to present revised financial policies and procedures and financial controls to the Board of Commissioners for review and approval.

3.4 Direct management to report audited fund balance as of June 30, 2011 as soon as practicable to the Board of Commissioners.

3.5 Direct management to prepare and submit quarterly financial reports to the Board of Commissioners based on full reconciliations of agency accounts and expenditures, and reporting fund balance elements as reported in the agency's audited Comprehensive Annual Financial Report (CAFR).

Costs and Benefits

Implementation of the recommendations would increase the efficacy of First 5 LA's accounting processes and financial reporting by shifting the workload from monthly compilation and annual reconciliation to a quarterly compilation and reconciliation. This would provide accurate and comprehensive financial status in a more timely manner. It would also reduce errors and omissions that later result in additional rework and adjustment. While the development of written procedures will require staff time initially, workload efficiencies will be realized once accounting and reporting processes become more formalized and systematic.